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The Family Limited Partnership

How to Transfer Your Business or Other Assets to Your Children without Losing Control

A family limited partnership lets you remove your business, and any future appreciation on it, from your estate now, while retaining some control. It is especially useful when the business might otherwise have to be liquidated to pay estate taxes. Stocks, real estate, or insurance can also be used instead of a business.

Here's how it works. When you set up a family limited partnership, you transfer the assets into the partnership in exchange for partnership shares. You keep the *general partner* shares and, over time, you can gift *limited* partnership shares to your children, removing the value of the gifted *limited* partnership interests from your estate.

Though you have a fiduciary obligation to the other owners, you control the family partnership as the general partner; you determine how the assets are managed, when income is distributed, and how the partnership is run. Limited partners (typically your children) are *passive* -- they have no say in how the partnership is managed. Profits and losses are allocated among the partners, but no income is distributed unless you, as the general partner, decide to do so. Also, the agreement can be written so that shares cannot be sold or transferred without your approval.

Because there is no market for these shares, their value is often discounted. (What would someone pay for minority shares in assets over which they have no control?) You are able to transfer these assets to your children and remove them from your taxable estate at a discounted value -- all without losing control.

If you gift shares in increments of $14,000, there is no gift tax. This "annual gift exclusion" amount can be given every year and adjusts annually for inflation. Larger gifts can be applied to your federal unified gift and estate tax exemption. (State taxes may also apply.) And since you are making gifts based on current value -- not the appreciated value when you die -- this lets you, in effect, freeze the value of the gifted assets at the time the gifts are made.

A family limited partnership gives you more control than a corporation, in which even minority stockholders (either your children or their creditors) can have substantial voting rights and can force sales, distributions, or even liquidations. The assets also have some protection from future lawsuits and your children's creditors; if a creditor is awarded a limited partnership interest, the creditor has no more rights than the previous limited partner.

This advanced estate planning strategy is not for everyone. Depending on your circumstances and goals, it might even conflict with other strategies (for example, limited partnership transferred to a child are not entitled to “stepped up” basis at death, which might increase a child’s income tax bill). Check with your attorney to fully explore the available options and to select the strategy that’s best for your circumstances.

Benefits of a Family Limited Partnership

- Assets of substantial value, and any future appreciation on these assets, are removed from your estate, reducing the size of your estate and saving estate taxes.
- The assets are often transferred at a discounted value.
- The assets can be gifted over time to family members as annual tax-free gifts (no gift tax).
- As general partner, you keep some control:
- You control how the assets are managed and how the partnership is run;
- You decide if any income is distributed;
- Shares may not be sold or transferred without your approval.
- Limited partners (other family members) have no say in how the partnership is managed.
- Assets have some protection from children's creditors and future lawsuits.